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ABSTRACT

An annual assembly of a panel of experts from the public and private sectors assessed specific foreign policy issues and recommended future direction. The oneset of the debt crisis in 1982 generated fears regarding the future of democracy in Latin America. The focus on the assembled experts was on the role of external pressures and the impact of U.S. policy, such as the Baker and Brady Plans, and of international financial institutions, such as the International Monetary Fund and World Bank. The United States can no longer control events in Latin America. The question now is how best to use the influence and resources that remain. Since the Cold War has ended, the United States now should support countries without fear of expansion of Soviet influence in the region. There was broad agreement among the participants that for Latin America to grow and develop, additional debt relief or loans should be granted by Europe, Japan, and Canada, and other industrialized countries should be encouraged to provide economic resources that are tied to economic reforms. (ML)

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Debt and Democracy in Latin America

30th Strategy for Peace, US Foreign Policy Conference 1989

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The Stanley Foundation

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About the Conference

Strategy for Peace, the Stanley Foundation's US foreign policy conference, annually assembles a panel of experts from the public and private sectors to assess specific foreign policy issues and to recommend future direction.

At the October 1989 conference, sixty-nine foreign policy professionals met at Airlie House Conference Center to recommend elements of a strategy for peace in the following areas:

1. Debt and Democracy in Latin America
2. Soviet Economic Reform: Socialism and Property
3. Crisis in China: Prospects for US Policy
4. Global Change and Africa: Implications for US Policy

The work of the conference was carried out in four concurrent round-table discussions. These sessions were informal and off the record. The rapporteurs tried to convey the conclusions of the discussions and the areas of consensus and disagreement. This is the report of one discussion group.

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The rapporteur prepared this report following the conference. It contains her interpretation of the proceedings and is not merely a descriptive, chronological account. Participants neither reviewed nor approved the report. Therefore, it should not be assumed that every participant subscribes to all recommendations, observations, and conclusions.

Debt and Democracy in Latin America

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Latin America Discussion Group

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Chair Susan Purcell and Rapporteur Susan Davis

Debt and Democracy in Latin America

Contrary to conventional wisdom, the debt crisis did not cause Latin America's current economic difficulties. Most Latin American economies were already experiencing problems prior to August 1982 when Mexico notified its creditors that it would be unable to service its multibillion-dollar debt. As a result of Mexico's de facto moratorium, commerical banks became reluctant to extend new credits to Latin America as a whole. Their behavior triggered a regional liquidity crisis; August 1982, therefore, has come to mark the date when the debt crisis began.

The onset of the debt crisis confronted incumbent governments with situations and conditions that offered a stark contrast to their experience during the preceding two decades. The 1960s and 1970s had been economic boom years for most of Latin America. Yet appearances were deceiving. In many cases, high rates of economic growth were the result of a combination of high prices for Latin American exports and heavy borrowing abroad to help offset growing budget deficits produced in part by ambitious state-sponsored development projects.

When capital markets dried up, many Latin American governments came close to bankruptcy. They quickly discovered that they lacked the funds, expertise, and financial and political institutions necessary for dealing with the debt crisis. Whether ruled by democratic, authoritarian, or military leaders, Latin American governments confronted an unprecedented situation with no known rules of the game that would guarantee their ability to survive.

Impact on Democracy Processes and Democratic Transition

The onset of the debt crisis generated fears regarding the future of democracy in Latin America. By mid-1982, some Latin American countries were already well-established democracies, such as Colombia and Venezuela. Others were weak and fairly young democracies, such as Peru and Ecuador. It was expected the problems generated by the debt crisis would cause the military in these countries—particularly the newer, more weakly institutionalized ones—to overthrow existing democratic regimes.

The years immediately following 1982 did not, however, prove as detrimental to incumbent democracies as had originally been anticipated. As civilian rulers searched for short- and long-term solutions to the crisis, their overthrow by the military became less likely, in part because military leaders realized that they were as ill-equipped as their civilian counterparts to manage the economic disintegration process or to regenerate their economies.

The debt crisis also did not short circuit democratic transition processes that were already underway. Countries such as Brazil, which began the move from authoritarian to democratic rule in the late 1970s, continued the political reform process. Like the military establishments in already democratic regimes, the military in countries in transition toward democracy did not relish the prospect of remaining in power in the absence of the plentiful resources to which they had become accustomed in the decades prior to the debt crisis.

If the debt crisis did not overthrow existing democracies or halt democratic transition processes, neither did it have the opposite impact of causing authoritarian regimes to transform themselves into democratic ones. It is true that there were more democratic

regimes in Latin America in the years following the onset of the debt crisis than there were before it occurred. In most cases, however, those countries that adjusted civilian democratic rule after August 1982 had begun the transition process prior to the debt crisis. Brazil is a good example. Although the country did not directly elect its president in a free election until 1989, the military began laying the groundwork for the transition process in the 1970s.

In those cases where the democratic transition began after the onset of the debt crisis, appearances are sometimes deceiving. Argentina is a good example. Its transition process began after mid-1982. The cause was not the debt crisis, however, but the military's defeat in the Falklands/Malvinas War against Great Britain, combined with long-standing military mismanagement of the economy.

Finally, the debt crisis did not force all authoritarian regimes to move toward democracy. A number of military leaders who were in power in mid-1982 managed to maintain control well beyond the onset of the debt crisis. Chile and Paraguay are examples. In both cases, the transition toward democracy began after the debt crisis and responded more to political than to immediate economic pressures.

Impact on Economic Policymaking

While it is difficult to generalize regarding the impact of the debt crisis on particular types of regimes or on political transition processes, it is possible to speak in general terms about the impact of the crisis on economic policymaking. Regardless of regime type, all Latin American countries were forced by the debt crisis to examine their economic policies and search for new strategies that would lead to economic growth. Throughout the region, this reevaluation generally led to a realization that the economic development strategy known as import-substitution-industrialization (which was statist, protectionist, and costly) could no longer be sustained in the absence of large influxes of foreign capital. As a result, the countries of the region began moving, albeit at different speeds, toward more open and liberal economies. Foreign investment has become more welcome. Protectionist barriers have begun

to fall in order to reduce inflation and force domestic producers to become more efficient, competitive, and export-oriented. Finally, government expenditures are being reduced through privatization or closure of costly government enterprises and elimination of government subsidies.

Relationship Between Regime Type and Economic Reform

The two countries in Latin America that have made the most progress in restructuring their economies in a more liberal direction are Mexico and Chile. In Mexico, the process was initiated by a dominant or "official" political party; in Chile, by a military officer. This has led to the impression that authoritarian regimes are better able to dismantle vested interests for the purpose of liberalizing their economies. Yet other authoritarian governments, such as those of Argentina and Brazil, either failed in their efforts to reduce statism and protectionism or did not respond to internal or external pressures to take such steps.

The record of democratic regimes in implementing economic stabilization and restructuring policies is equally mixed. Civilian presidents with strong electoral mandates, as was the case with Raul Alfonsin in Argentina, failed to halt inflation and significantly liberalize the economy. The same was true of Brazil's President Jose Sarney. The failure of economic reform efforts in both administrations has led some observers to conclude that the problem lies with weakly institutionalized democratic political structures.

On the other hand, Bolivia, which is also characterized by weak democratic institutions, nonetheless has managed to make a number of difficult decisions to stabilize and liberalize its economy, despite opposition from powerful vested interests. Part of the explanation was the ability of President Victor Paz Estenssoro to win the support of his main political rival for his reform efforts. A broad elite consensus, therefore, may ultimately be more important in explaining a particular country's ability to restructure its economy than whether it is governed by a democratic or authoritarian ruler.

The reasons why particular elites are able to reach agreement regarding the necessity or desirability of economic reform, however, are more difficult to explain. In some countries, drastic action

was postponed until the economy appeared on the verge of collapse, as in Bolivia. In Mexico, in contrast, the government decided to act before inflation spiraled into hyperinflation. These differences in timing appear to be related to differences in public tolerance of inflation and decline in living standards, the quality of political leadership, and a country's vulnerability to external pressures, to cite just a few relevant factors.

The Debt Crisis and Populism

The fact that there appears to be a developing consensus in favor of the need to liberalize Latin America's statist and protectionist economies seems to contradict a widely held expectation that the debt crisis would produce a return to the populist politics that characterized Latin America in the 1960s and 1970s. The theory held that faced with impending economic and political disintegration or collapse, Latin America's leaders would try to build political support by promising to redistribute resources and increase spending.

Presidential elections in the late 1980s did, in fact, bring to power a number of individuals who were considered populist politicians. These included Carlos Andres Perez in Venezuela, Carlos Saul Menem in Argentina, and Rodrigo Borja in Ecuador. Contrary to expectations, however, none of these presidents has publicly advocated such politically expedient policies. Instead, all have promised to reduce state spending, dismantle protectionist barriers, reduce inflation, and increase production and efficiency in order to raise exports.

It is too soon to conclude that all these presidents will succeed in implementing the policies they claim to support and refrain from sliding back into old behavior patterns. On the one hand, the scarcity of capital may work to keep them committed to liberalizing their economies as the only available means to restore economic growth. On the other hand, if political obstacles to economic restructuring prove too formidable, or if economic growth continues to prove elusive despite initial reforms, growing popular discontent may ultimately push them to adopt more populist policies.

To date, the failure of the debt crisis to produce a return to the

populism of the past does not, therefore, necessarily mean that it will not do so tomorrow. Throughout Latin America, important opposition leaders and their followers continue to advocate debt moratoria, a strong state role in the economy, and implementation of redistributive policies in order to achieve an economic revival. These same individuals remain suspicious both of foreign investors and their own domestic private sectors and argue that the development strategies of the 1960s and 1970s should be improved upon rather than abandoned. Cuauhtemoc Cardenas in Mexico and Luiz Inacio da Silva (Lula) in Brazil are examples of such leaders.

At the very least, therefore, the debt crisis and the associated economic, political, and social problems seem to be producing a growing polarization, at least on the rhetorical level, within Latin America. It is still too early to tell whether the polarized rhetoric will lead to a swing away from liberal policies and a return to populism. It is also possible, of course, that political leaders will instead attempt to pursue liberal and populist policies simultaneously. To some extent, this is already occurring in countries such as Venezuela, Mexico, and Argentina, whose governments have continued to overspend and overborrow domestically despite their overall commitment to economic liberalization and stabilization.

Link Between Economic and Political Liberalization

If the region's governments do succeed in holding the line against populist politics and instead continue dismantling the economic role of the state and decentralizing economic decision making, some observers believe that military coups could become a thing of the past. They argue that statism in Latin America has constituted an obstacle to democratic institutionalization by allowing authoritarian structures to persist. A smaller state and the decentralization of economic power toward state and local groups and organizations would strengthen grass-roots democracy. Latin America could then permanently break with the cyclical alternations between civilian and military governments that have characterized the region to date.

It is still too early to prove or disprove this hypothesis. Nor is it possible to determine the accuracy of a related belief that authoritarian regimes that adopt liberal economic policies will eventually

be obliged to liberalize politically as well. An argument can be made that after implementing economically liberal policies, Mexico then made a number of political changes that made its political system more democratic. Yet Mexico's dominant party had begun introducing political reforms well before the debt crisis obliged it to begin liberalizing the economy. Therefore, the political reforms adopted since 1982 represent the continuation of an earlier trend, although the debt crisis may have accelerated the political reform agenda. On the other hand, a point may be reached where the viability of economic reforms will be undermined unless the government fully democratizes the political system.

The Role of External Pressures

While it is generally agreed that the onset of the debt crisis provoked a rethinking of Latin America's development strategy, there is considerable debate over whether external actions played a decisive role in moving Latin America toward more liberal economic and political policies. In the economic arena, the discussion focuses in particular on the impact of US policy, particularly the Baker and Brady Plans, and of international financial institutions, such as the International Monetary Fund and World Bank. In the political sphere, the focus is on US and international pressures in favor of human rights and democratization.

Both the Baker Plan and its successor, the Brady Plan, represented attempts to resolve the debt crisis and restore economic growth by advocating the provision of new money conditioned on debtor countries' implementation of liberal economic policies. The main difference between the plans is that the Baker Plan provided for debt relief but not debt reduction while the Brady Plan accepted the need to offer debt reduction as an option. Both plans, however, gave the International Monetary Fund an important role in conditioning new lending on the implementation of economic adjustment and stabilization policies in the debtor countries.

Some observers regard the Baker Plan as a failure. They argue that it did not resolve the debt crisis and, instead, served to increase rather than decrease Latin America's debt burden. Conditionality was ineffective in pressuring governments adequately to restructure their economies, and no new money, other than funds

earmarked to pay interest due on existing loans, was forthcoming. Other analysts, however, claim that the Baker Plan, particularly its provisions for conditioned loans, caused or enabled Latin American leaders to implement difficult and potentially politically costly decisions that would or could not have been made in the absence of the plan. They further argue that the absence of a substantial inflow of new money prevented Latin leaders from returning to their free spending, populist ways and, instead, obliged them to press ahead with economic restructuring.

A similar lack of consensus exists over the Brady Plan. Some praise it for recognizing the need to reduce Latin America's debt burden, although many of these individuals believe that the debt reduction provided for is inadequate. Others argue that the plan has done more harm than good; by accepting the principle of debt reduction, it has given commercial banks an incentive to withdraw from Latin America instead of encouraging them to provide new money to the region.

Disagreement also characterizes the discussion regarding the role of external pressures favoring democracy and human rights. Some argue that they were decisive in forcing democratic openings in Latin America and curtailing human rights abuses. Others believe that progress in both areas resulted principally from domestic pressures, both political and economic, although the relative importance given to both kinds of pressures varies.

Implications for US Policy

The days are past when the United States could control or decisively influence events and developments in Latin America. Nevertheless, Washington is not without influence or resources. The question is how best to use what influence and resources remain at its disposal.

It is obviously easier and more rewarding to work with governments and groups in Latin America who want to work with the United States. The debt crisis and its political and economic consequences have brought to the fore new economic and political leaders, both in the public and private sectors, who are committed to modernizing their governments and societies. They generally

favor the establishment of a good working relationship with the United States and welcome US help, cooperation, and attention. The United States should strengthen the position of these new leaders by orienting its policies toward them.

The improved relationship between the United States and the Soviet Union should make this approach more feasible. In the past, the fear of expansion of Soviet influence in the region often led Washington to support governments that were undemocratic and pursued economic policies that had few prospects for generating sustained and equitable growth. The winding down of the Cold War should now allow the United States unequivocally to support governments and private groups committed to democracy and economic reforms that will lead to growth and development.

There is broad agreement that for Latin America to grow and develop, additional debt relief or loans should be granted. Such relief or loans should be conditioned to the implementation of reforms that would allow the effective use of the additional resources. Otherwise, unconditioned relief or new money would mainly be transformed into capital flight. The challenge, therefore, is to provide enough conditioned resources to support the efforts of democratic leaders in Latin America to reform their economies.

At the same time, the United States should continue to resist protectionist pressures at home since Latin American access to the US market remains crucial for the region's recovery. And the economic recovery of Latin America would contribute significantly to the recovery of lost US export markets.

Democratic leaders in Latin America deserve US support but not only because their values coincide with those of the United States. They should also be favored because, ultimately, the solution to the debt crisis and the revival of economic growth in Latin America will depend on the adoption of responsible politics that hold people accountable for their decisions. This is what democracy is all about.

Democracy also implies a certain degree of political decentralization. This too has implications for US policy. Support for democracy and economic reform need not be focused only on gov-

ernment-to-government relations. Private groups in the United States, such as business, labor, religious, or environmental associations as well as individuals, should be encouraged to identify and work with their counterparts within Latin America.

Finally, in today's world it is not enough for the United States unilaterally to support all these policies. Europe, Japan, Canada, and other democratic, industrialized countries also have a stake in Latin America's economic recovery and democratic institutionalization. They should, therefore, be encouraged to provide additional economic resources to Latin America, conditioned on economic reforms, and to support development in the region that enhances the prospects for responsible, democratic government.

President's Address

by Richard H. Stanley
President, The Stanley Foundation

Richard Stanley opened the Strategy for Peace Conference with the following remarks, addressing all participants from the four topic groups.

For the past thirty years this conference series has been dedicated to the development of US policy. This year is no different. However, we all know that the context of policy formulation, whether direct as in the case of our group on China, or indirect as with our group on Soviet economic reform, has altered significantly as the world and our relative position in it have changed fundamentally over the past three decades. This simple observation prompts me to ask you to consider in your deliberations two larger, underlying issues that will define the context for US policy: first, the changing national power relationships including the relative erosion of US power since our immediate post-World War II period of dominance; and second, the profound global systemic changes that are rendering old policy assumptions and formulas obsolete.

Let me elaborate. First, with regard to the relative decline of US power, I think the facts are clear while interpretations may vary. For example, we are all well aware that in the space of a few years the United States has gone from being the world's largest creditor nation to being the world's largest debtor nation as we continue to import capital to offset our decline in world markets. Our trade and budget deficits exceed $100 billion annually which is also a relatively new phenomenon, at least in terms of the size of the deficits. In another area of national power we remain the world's preeminent military power, but we are finding that military

strength, a continuing necessity for the present and foreseeable future, has brought on obligations and problems that outstrip our means, a dilemma Paul Kennedy has labeled "imperial overstretch." Additionally, we, as well as the Soviets, have learned hard lessons about the limits of military power. We have finally realized that the absolute power of strategic weapons makes their use unthinkable. The two superpowers are like hulking giants who dare not unleash their might, thus rendering these massive arsenals nearly impotent in terms of enforcing political decisions. Both have learned hard lessons about the limitations of superior conventional forces in Viet Nam and Afghanistan respectively and are now beginning to understand the Pandora effect of conventional weapons proliferation in the Third World.

These economic and military trends have been a blast of cold reality and have caused some to make alarmist predictions about the decline of US power and the disaster awaiting the US economy. Others have chosen to deny the trends, relying instead on nationalist sentiment and a retrenchment of old policies from the glory days of US dominance. Before following either path, or any in between, I hope we will first be willing to make a sober assessment of the degree and nature of decline and how it relates to a broader global adjustment toward a more multipolar world.

Second, and just as obvious as the altered status of US dominance, is the fundamental change occurring in the nature of the world. This change is evident in the form of globalization of both problems and systems. For example, the economic system has been internationalized as nonstate economic actors such as transnational corporations and major financial institutions have grown in size and power. This change has greatly curtailed the ability of national governments to independently manage their own economic futures.

The environment illustrates the globalization of a problem. The global dimensions of this issue have only recently surfaced. Thirty years ago we knew little about pollution and treated it as a local problem. Today the environmental crisis threatens the very ecosystem that sustains life on this planet. Clearly, the greenhouse effect, depletion of the ozone layer, ocean pollution, deforestation, and desertification are among several examples of truly global and

basic problems that defy traditional state-oriented solutions.

While our conference topics were never intended to be related in any way, they are all linked by these overriding issues that I believe will help form the basic context for the formulation of US policy.

Our discussion on "Global Change and Africa: Implications for US Policy" acknowledges the need to deal with these issues in its title as well as in its objectives. Fundamental changes in the international system have significantly altered the context within which US policy toward Africa will be formulated and implemented. This discussion group will build on the growing awareness of these developments and of their impact in Africa in an effort to develop guidelines for effective multilateral initiatives there.

The group examining "Soviet Economic Reform: Socialism and Property" will seek to go straight to the heart of the Soviet effort to respond to its own decline in power and its effort to continue as a great power through economic and political reform. The Soviets must attempt these efforts in an evolving international context. They have been our major rival and the motivation for much of our foreign policy for some forty years. They will continue to be of major concern for the foreseeable future, but the importance of the rivalry is declining. The Soviets are clearly in a less advantageous position than the United States to meet these new challenges. However, you can be sure that the success or failure of their efforts will have significant implications for US policy.

Those of you here to investigate the relationship between "Debt and Democracy in Latin America" are no doubt well aware of the interplay of state and nonstate economic actors in this region. It is my belief that Latin America will be of profound importance to the future of US political-economic policy. This region, that has seen so many years of US domination, will no doubt hold many lessons for the United States as we adapt to new political and economic relationships.

Finally, the discussion group on the "Crisis in China: Prospects for US Policy" offers a fascinating opportunity to examine our own response to the situation in China as well as to the actual events

taking place there now. Are economic sanctions and political threats effective or desirable methods in face of the recent aberrant behavior of the Chinese government? What is the appropriate role for the US, and what are its duties and obligations? How effective can we be? Do we need to develop new methods to achieve our objectives?

I should say at this point that I am not trying to paint a particularly negative picture of the future, but I believe change is underway and its continuation is inevitable. Therefore, my plea to you is to look to the future and to the new global realities as you develop policy criteria. Perhaps Paul Kennedy sums up all this best in his book, *The Rise and Fall of the Great Powers*, in the following passages:

> The task facing American statesmen over the next decades, therefore, is to recognize that broad trends are underway, and there is a need to "manage" affairs so that the relative erosion of the United States' position takes place slowly and smoothly, and is not accelerated by policies which bring merely short-term advantage but longer-term disadvantage. ...
>
> In all of the discussions about the erosion of American leadership, it needs to be repeated again and again that the decline referred to is relative not absolute, and is therefore perfectly natural; and that the only serious threat to the real interest of the United States can come from a failure to adjust sensibly to the newer world order.

Having laid out these challenges and having asked that you give them some consideration, I feel obligated to share with you some early thoughts on how we might respond. First, I think that we are looking for ways to proceed and not for grand theories or solutions to impose. Simply put, I think the best approach would be process-oriented.

One of the more immediate responses I would recommend is elimination of the increasingly false dichotomy separating foreign and domestic policy. Can we any longer have a domestic environmental policy and a foreign version? Surely the debt problem in Latin America has domestic implications. Iowa farmers are well aware of the domestic impact that Soviet economic and agricultural reforms can produce. Drug policy is another example of the

blurring of foreign and domestic issues. And with the growing public interest and formation of politically active groups concerned with China, domestic implications will soon be felt.

The joining of foreign and domestic policy is closely related to a second pressing need: better coordination of national policy. All too often foreign nations get one word from Treasury and another from State. We have different national agendas that only serve to send mixed signals and exacerbate problems. What are the priorities of our policy toward Latin America? It depends on whom you talk to—the banks want their money and the State Department wants democracy. I don't believe these issues are antithetical, but the prospects for both might be improved through better coordination of policy. It almost goes without saying that greater consideration must be given to multilateral options in meeting the problems and challenges that lie ahead. As I have already noted, by their very nature, the internationalization of the economy and the planetary threats to the environment defy any unilateral or bilateral attempt at resolution. Add to this the growing level of poverty, overpopulation, international health problems, as well as nontraditional threats to security like terrorism and drugs, and the need for greater consideration of multilateral alternatives is mandatory. It is time to build the international institutions needed to assist in meeting these problems.

Perhaps the most difficult and profound adjustment is the rethinking of our view of ourselves in the world. I recently chaired an international conference on the environment. During discussion of sustainable development, a concept of development that is environmentally sound and regenerating, one of our participants from a developing country stated bluntly that sustainable development will not be possible until the people of the developed world enter into a solidarity pact with the people of developing countries that acknowledges that all our lives are equally important. I do not mean to sound some simplistic call for us to raise our level of consciousness to do right and be good. Rather, I want to underscore the fact that we have yet to learn to think of ourselves as part of a global system. We have not acknowledged or internalized our interdependence with the people or the planet. The United States is a great nation that has proven time and again its resourcefulness, its intelligence, and its courage to meet new challenges—we must now add maturity and wisdom to meet the challenges ahead.

I look forward with great anticipation to your stimulating discussions. I trust that they will prove productive and creative and that together we may make a modest contribution toward a secure peace with freedom and justice.

The Stanley Foundation

Activities

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